

Online Class / week #7

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- (1) Complete discussion of poison pills
- (2) M&A Contracts
- (3) Restructuring at Marvel Entertainment Group

Course Evaluation:

eval.ou.edu

Thank you for taking the time to complete it!

✓ Final Exam

- Wednesday, 12/8, 12:01 am CST - Saturday, 12/11, 11:59 pm CST
- 90 + 5 minutes to complete
- Five questions, selected at random from the list of eligible questions

(Continuation from last class)

M&A Defense Mechanisms

Internal
Mechanism:

- staggered board

✓ - poison pill

- super majority requirement
to amend charter or bylaw

- dual class structures

External Mechanisms:

- Regulators

- Activist investors

- Market for corporate control

Discussion of Takeover Defenses & Poison Pills

shadow pill vs. ^{visible} poison pill

A visible poison pill = A discriminatory dividend rights plan!

Example:

Flip-Over Pill Example: (more common in Europe)

Before
merger

Buyer

51% (sh)

Seller

49% (sh)

After merger
w/ flip-over pill

$$\frac{51 + 0}{51}$$

$$\frac{51}{51 + 98} = 34.2\%$$

$49 + 49$ newly issued shares (as dividends)

98

$$\frac{98}{51 + 98} = 65.8\%$$

Discussion of poison pills

Poison pill — a discriminatory dividend plan executed by the corporate board against an acquirer (unsolicited) who acquires $X\%$ or more of the target stock.

- every one else among shareholders gets stock dividend @ discount price
- control-seeking acquirer does not get such dividend
- usually X is 10%

Poison pills types:

- ✓ — flip-in —→ e.g. Conrail had it; it permits shareholders except acquirer, to purchase additional shares at a discount. It dilutes shares held by hostile acquirer while such acquirer is attempting to gain control.
- ✓ — flip-over



Enables shareholders (who do not seek control) to purchase acquirer's shares after merger @ a discount

Poison Pill

Tactic utilized by companies to prevent or discourage hostile takeovers.

Types:

1. "Flip-in" ✓

Permits shareholders, except acquirer, to purchase additional shares at discount. It provides investors with instantaneous profits & dilutes shares held by the acquirer.

2. "Flip-over" ✓

Enables stockholders to purchase the acquirer's shares after merger @ discount. For example, shareholder has right to buy stock of acquirer in subsequent merger @ two-for-one rate.

Standstill agreements

The target's final concern is that having divulged its trade secrets to the buyer, the buyer will short-circuit the merger negotiations and proceed to acquire the target through open market purchases or a tender offer directly to target shareholders. Some confidentiality agreements will prohibit the acquirer from purchasing, in the market or through private transactions, shares of the seller for a specified period of time—generally two to five years. This agreement of the buyer is sometimes more broadly drafted to preclude initiation or participation in unsolicited tender offers or proxy solicitations.

The buyer will often request that the standstill should permit the right to purchase a toehold interest in the target, up to 4.99 percent of its shares outstanding—just below the five percent threshold for reporting the equity stake to the SEC as required by law.² This is both an expression of serious interest to the target, and a means of hedging against the loss of the target to another buyer willing to pay a higher price. Profits on toehold positions are sometimes justified as compensation for expenses incurred in due diligence and deal development.

Generally, the standstill is most relevant for public targets, whose shares are traded on an exchange. But the standstill could also be highly relevant for a privately owned target where the shareholders have divided into opposing groups with one group threatening to sell to the next available buyer.

The standstill agreement takes the form of a brief letter signed by the buyer and countersigned by the target. It is often signed early in the deal development process and often bundled with agreements about confidentiality, exclusivity, and termination.

no proxy
solicitation
no tender
offers
that are
unsolicited

Additional Discussions:

Governance Mechanisms
(in the context of alternative
methods to transfer control over
the corporation)

alternative
to M&A



Discussion of incentive compensation

Incentive Pay Format

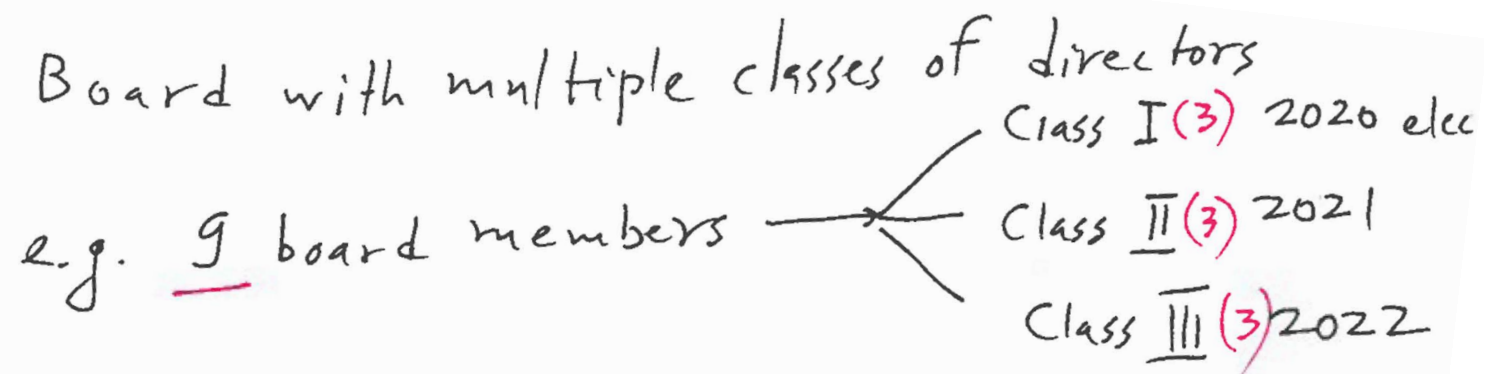
- Options no more
 - RSU — restrictive stock units
 - PSU — performance stock units
- ↓
authorized, but not issued

Discussion of classified boards

Classified Board -

Board with multiple classes of directors

e.g. 9 board members



Alternative: proxy fight → buy stock & then attempt to raid the board
(shareholder meeting)

Board of Directors

[Unitary vs. Classified Board]

↓
1 class
(elected annually)

↓ 3 classes
(one class only elected each year)

use of
Bloomberg
for
M & A
data

{ MRGC → pro-forma valuation (for potential deal scenarios)
BUYP → complete deal detail + timeline
MA → for the entire market

HP/Compaq
Comrail A
Seagate } mandatory
reports
for 3 case studies

M & A CONTRACTS

Deal Points Study (2015) (for private target acquisitions)

slides

- Escrow Agr.

15, 94-96

- Earnout

17-19, 21

- MAE

23, 24, 26-28

- No shop

45

- MAC

55

- Appraisal Rights

60

- CAPS

84-85

- Sand bagging

63

- Basket

76-77, 79-80

- Dispute Resolution

103

M&A Contract Clauses

- ✓ - Baskets
- ✓ - Sandbagging clause
- No-talk / No-shop
- ✓ - Caps
- ✓ - Escrows
- ✓ - Earnouts
- ✓ - Appraisal rights
- ✓ - MAE / MAC

Earnouts

2% of all public targets

26% of all private targets

Escrow agreement

0% in public target deals

52% in private target deals

18 months → J.P. Morgan

12% of transaction value

Escrow Agreement

Ent. Value / EBITDA

$$\boxed{10} \times 10m = \text{EBITDA}$$

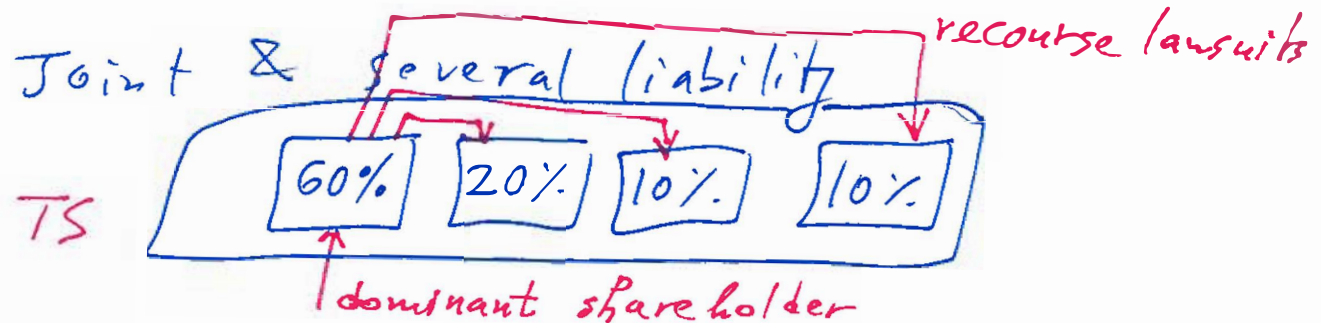
12% of sales price $\$100m$ → deposited w/
custodian bank
for 18 months.

However, if $8m = \text{EBITDA} \rightarrow \text{price} = 80m \$ \Rightarrow$ recourse against
the escrow accounts

52% of all private target acq. \Rightarrow use
escrow agreement
0% of all public target acq.

✓ Target - side acquisition transaction risk.

Escrow allows
target to



Economic rationale behind use of escrow agreements in private target acquisitions

Escrow agreements are more frequently used in private target acquisitions if:

1. It is more important for the bidder to ~~manage~~ ^{acquire} acquisition-related transaction risk. Use is more common in subsidiary versus private stand-alone firm acquisitions. In the case of subsidiary acquisitions, a bidder would have legal recourse post-deal closure against both the parent firm that sold the subsidiary and the principal shareholders of the parent firm, while for private firm acquisitions the bidder would only have recourse against the principal shareholders of the target. Escrow contracts are used in 65% of private firm acquisitions, but these contracts are used in only 32% of subsidiary acquisitions.
2. There is more information asymmetry about the target's value the bidder faces greater transaction risk, in these instances the benefits to using an escrow contract should be larger. Whether an escrow contract is used in the context of the acquisition of an unlisted target is positively associated with: (1) earnings volatility in the target's industry, (2) if there is a smaller number of analysts covering the target's industry, (3) if the target operates in a different industry than does the bidder, (4) the target's total accruals, and (5) if a target's interest coverage ratio is low.
3. When there is high target-side acquisition-related transaction risk. When a target has a dominant shareholder, defined as a shareholder who owns at least 20 percent of the target's shares but not all of its shares, an escrow contract can be particularly useful to manage this shareholder's transaction risk. If such a contract is in place all target shareholders would bear pro rata costs of bidder recourse actions subsequent to an acquisition. In contrast, if such a contract is not in place in most cases bidder recourse actions subsequent to an acquisition would result in the target's dominant shareholder being held liable and sued by the bidder.¹
4. In acquisitions where due diligence costs are large relative to deal value due to significant information asymmetry about the target's value. The use of an escrow contract is expected to reduce a bidder's need to incur significant due diligence costs in these deals.

	Unlisted targets	Unlisted targets with escrow contract (52% of all)	Unlisted targets w/out escrow contract
Percent of deals that are stock purchase transactions	73.7%	80.0%	66.8%
Percent of deals that are asset purchase transactions	26.3%	20.0%	33.2%
Percent of deals for stand-alone private firm targets	60.3%	75.6%	43.8%
Percent of deals for subsidiary targets	39.7%	24.4%	56.2%
Percent of deals with a dominant target shareholder	36.8%	48.3%	24.1%
Percent of deals with a liability cap	73.7%	85.3%	61.1%

¹ In such cases, the dominant shareholder could then sue smaller shareholders to recover some of their share of the sale proceeds. However, given that these recourse lawsuits are costly, the use of an escrow contract would be a more efficient way for the dominant shareholder to manage acquisition-related transaction risk.

MAE / MAC clause

How is it
defined?

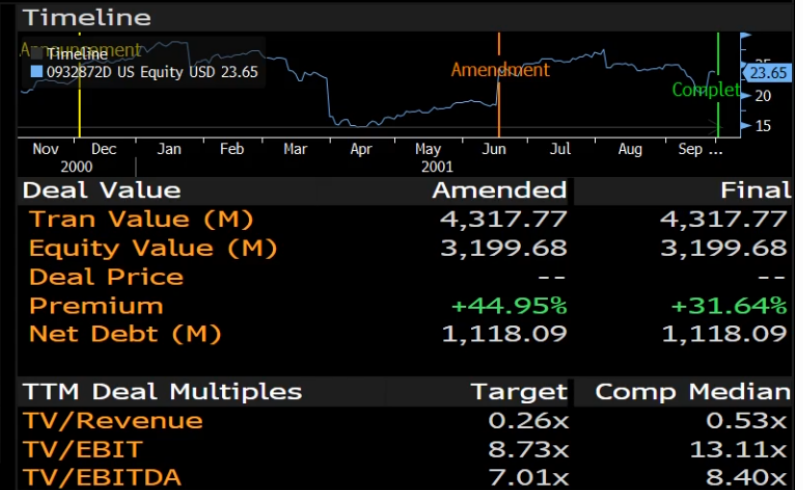
- (1) Clause itself
- (2) Exceptions (carve-outs) of the MAE/MAC clause

Rejected MAC/ MAE motions to cancel a merger

In 2000, Tyson Foods Inc. (TSN US Equity) sign merger contract with IBP Inc, but then argued about foiling the contract due to MAE.

1. Tyson Foods Inc. acquisition of Iowa Beef Producers Inc. (also known as Tyson Fresh Meats Inc.)

Target	1) Tyson Fresh Meats Inc 0932872D US Px USD 23.65 Food-Meat Products	Acquirer	2) Tyson Foods Inc TSN US Px USD 10.29 Poultry	Currency	USD
				Announcement	12/04/00
				Transaction Value	4,317.77M
Details	Description				
11) Summary	Tyson Foods Inc acquired Tyson Fresh Meats Inc for USD 4,317.77M. The transaction was announced on 12/04/2000 and completed on 10/01/2001.				
12) Timeline					
13) Parties					
14) Proration					
15) Structure					
16) Advisers					
17) Sources/News					
Comps	Dates				
18) Deal Comps	Announcement 12/04/00				
Markets	Amendment 06/18/01				
19) Arbitrage	Completion 10/01/01				
	Status Completed				
	Duration (# Days) 301				
	Deal Terms				
	Nature of Bid Friendly				
	Percent Owned/Sought 0.00% / 100.00%				
	Payment Type Cash or Stock				
	Cash Terms (per Tgt Sh) USD 30.0000				
	Stock Terms (Acq Sh/Tgt Sh) 2.3810				
	Deal Attributes				
	Tender Offer, Company Takeover				
ID	6082780	Notes	CASH TENDER OFF EFF: 8/3 (50.1%). SECOND STEP: TGT SHRHLDRS TO REC 2.381 TSN		



- The Chancery Court in Delaware mandated that the merger be completed.
- Sets case law precedent for the MAE clause to rarely be successful applied to terminate a merger
- The only case where MAE clause was successfully applied to terminate a merger → 10/1/2018, Akorn vs. Fresenius Kabi AG

Hexion Specialty Chemicals (owned by Apollo Management Group) acquisition of Huntsman Inc.

In 2008 Apollo Management group contested the merger of its wholly-owned subsidiary Hexion with Huntsman → they argued in favor of a MAC (material adverse change) clause applicability

APD US Equity

Target	1) Huntsman Corp HUN US Px USD 3.44 Chemicals-Diversified	Acquirer	2) Apollo Global Management... APO US Private Equity	Currency	USD
				Announcement	12/15/08
				Transaction Value	250.00M
Details		Description			
11) Summary	Apollo Global Management Inc acquired a minority stake in Huntsman Corp. The transaction was announced on 12/15/2008 and completed on 12/31/2008.				
12) Timeline					
13) Parties					
14) Advisers					
15) Sources/News					
Comps	Dates				
16) Deal Comps	Announcement 12/15/08 Completion 12/31/08 Status Completed Duration (# Days) 16				
	Deal Terms				
	Nature of Bid Friendly Percent Owned/Sought 0.00% / 12.14% Payment Type Cash Cash Terms (M) USD 250.0000				
	Deal Attributes				
	Minority purchase, Private Equity				
	Timeline				
	Deal Value				
	Tran Value (M) 250.00 Equity Value (M) 250.00 Deal Price -- Premium -- Net Debt (M) --				
	TTM Deal Multiples				
	TV/Revenue 0.19x TV/EBIT 4.54x TV/EBITDA 2.44x				
	Target 3.89x Comp Median 28.11x 5.94x				
ID	34852531	Notes	ACQ'R PURCH 7% CONVERTIBLE SENIOR NOTES. CONVERSION PRICE APPROX \$7.72. SEE ADDL		

The Delaware court of Chancery disagreed & the merger had to be completed.

Marvel Entertainment Group
Case Discussion

Marvel Entertainment Group Restructuring, HBS case

Proposed reorg. plan in Ch. 11

- Invest \$365 m for 427 m shares (newly issued & authorized)
- Acquisition of Toy Biz for \$326.8 m
- Exchange bonds with face value of \$894 m for equity collateral (of 77.3 m shares)

Alternative?

- Liquidation

Need to compare the two alternatives!

Exhibit 7

Exhibit 7 Liquidation Analysis (\$ millions)

Gross proceeds from disposition of operating assets ^a	\$447.0
Chapter 7 costs	
Transaction costs ^b	
Case related administrative expenses ^c	
Total Chapter 7 costs	10.5
Net proceeds from disposition of operating assets	436.5
Less Panini debt	192.1
Net proceeds available for other creditors	244.4
Net proceeds available for other creditors from sale of Toy Biz shares ^d	124.7
Total net proceeds available for other creditors	369.1
Secured claims ^e	535.4
Percent recovery against secured claims (mainly debt)	68.9%
Proceeds available for other claims	0.0%
Other administrative claims ^{f,g}	94.1
Percent recovery against other administrative claims	0%
Unsecured deficiency claims	166.3
Percent recovery against unsecured deficiency claims	0%
Proceeds available for common equity shareholders	\$0.0

{ court,
 legal counsel, ← 4.5
 valuers, ← 6.0
 auditors
 10.5

→ none available
 (ergo, reorganization plan is better)

$$\frac{369.1}{535.4} = 68.9\%$$

- severance to executives
 - settlement of accounts payable

Make-up Quiz #7 (Week #7) for FIN 5372

✓ Question #1 (0.5 pts)

(Essay Question #1 relates to the HBS case to be discussed in class, Restructuring at Marvel Entertainment Group; please target a response of about 100 words)

Why did Marvel file for Chapter 11? Were the problems caused by bad luck, bad strategy, or bad execution?

- ✓ - Business model restructuring
- Excessive burden of debt (caused by parent group)
- Preservation of NOL & control

✓ Question #2 (1 pts)

(Essay Question #2 relates to the HBS case to be discussed in class, Restructuring at Marvel Entertainment Group; please target a response of about 150 words)

Please evaluate the proposed restructuring plan. Will it solve the problems that caused Marvel to file for chapter 11? As Carl Icahn, the largest unsecured debt holder, would you vote for the proposed restructuring plan? Why or why not?

- Not solving the current problems of Marvel
- Carl Icahn not to vote in favor of this plan

✓ Question #3 (0.5 pts)

(Essay Question #3 relates to the HBS case to be discussed in class, Restructuring at Marvel Entertainment Group; please target a response of about 100 words)

Why did the price of Marvel's zero-coupon bonds drop on Tuesday, November 12, 1996? Why did portfolio managers at Fidelity and Putnam sell their bonds on Friday, November 8, 1996? Will it be difficult for Marvel or other companies in the MacAndrews and Forbes holding company to issue debt in the future?

- Price dropped b/c of rumors of bankruptcy
- Putnam & Fidelity sold due to a tip
- No anticipated negative impact on Marvel's &

✓ Question #4 (1 pts)

The most common Material Adverse Effect (MAE) clause carve out in private target acquisitions - according to the ABA Deal Points study - was:

- A. Industry conditions
- B. War or terrorism
- C. Change in accounting
- ✓ D. Economic conditions
- E. Financial market downturn

MacAndrews & Forbes ability to borrow in the future

✓ Question #5 (0.5 pts)

Anti-sandbagging clause is seller-friendly as it limits buyer's post-closing remedies for a seller's breach of representation, warranty or covenant if buyer had knowledge of such breach prior to closing.

- A. True
- B. False

✓ Question #6 (0.5 pts)

The true deductible basket is less common than the first dollar basket in private target acquisitions.

- A. True
- B. False